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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	)	MM Docket 92-266

COMMENTS OF The Disney Channel

IN RESPONSE TO THIRD NOTICE OF PROPOSED RULEMAKING

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Act of 1992	)	
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Rate Regulation	)	
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To: The Commission

COMMENTS OF THE DISNEY CHANNEL IN RESPONSE TO THIRD NOTICE OF PROPOSED RULEMAKING

The Disney Channel ("Disney") submits the following comments ("Comments") in response to the Commission's Third Notice of Proposed Rulemaking ("Third Notice") in the above-referenced proceeding.

INTRODUCTION

In its Third Notice, the Commission seeks comment on "the appropriate methodology for use of the benchmark to adjust capped rates when channels are added or deleted from a regulated tier . . . ."[1] We focus these Comments on this important issue in an

1 Rate Regulation Third Notice of Proposed Rulemaking, MM Docket No. 92-266, Report No. 93-428 (released Aug. 27, 1993) at ¶ 132.

effort to help the Commission resolve this issue expeditiously. As we explained in our Petition for Clarification and Reconsideration (filed June 21, 1993) ("Disney Petition"), absent such resolution, programming like The Disney Channel cannot and will not be made available to consumers on a regulated tier of programming (as it had been prior to the Rate Order) because the license fee will virtually always exceed a cable system's per channel benchmark.[2] Consumers will thus be deprived of the opportunity to receive The Disney Channel at a reduced price.

For the reasons stated below, The Disney Channel believes the methodology referred to by the Commission as the "third approach" -- with some small, but important, modifications -- is consistent with the goals of Congress and the Commission. Therefore, with these modifications, The Disney Channel supports the prompt adoption of the third approach.

THE COMMISSION SHOULD IMMEDIATELY ADOPT THE METHODOLOGY REFERRED TO AS THE "THIRD APPROACH" FOR ADJUSTING CAPPED RATES BASED ON CHANGES IN PROGRAMMING COSTS, WITH CERTAIN SMALL, BUT IMPORTANT, MODIFICATIONS

In determining the best methodology for adjusting capped rates, the Commission seeks to preserve incentives for cable operators to provide additional programming services to consumers, while protecting consumers from unreasonable rates.[3] These objectives are laudatory and consistent with the 1992 Cable Act and its legislative history.[4]

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2 Disney Petition at 6.

3 Third Notice at ¶ 136.

4 *See* 47 U.S.C.A. § 521(b) (West Supp. 1993).

Indeed, it was precisely to achieve these goals that The Disney Channel, in its Petition, suggested that cable operators be permitted to adjust their rates to pass through programming costs for newly added services to the extent those costs exceed systems' marginal per channel benchmarks.[5] Our suggestion was based on what cable operators were telling us (and continue to tell us): in deciding whether to add a program service to a regulated tier they compare the cost of the programming to the amount they would be permitted to charge for the additional channel.[6]

In its Third Notice, the Commission rejects Disney's marginal per channel benchmark proposal and instead proposes a methodology that allows cable operators to recover the actual increased cost of programming, including increased costs resulting from the addition of new services, so long as decreases in programming costs are also reflected in a cable system's rates.[7] While not perfect, the third approach is the best of the Commission's three proposals. First, it is consistent with the logic of the benchmark system adopted by the Commission.[8] Second, it goes the farthest of the proposals in fostering the Commission's goal

5 Disney Petition at 9, 10.

6 Rhetorical questions from cable operators such as: "How can I put your service on a tier if I can only charge 15¢ for it?" are representative of those that are frequently asked of Disney affiliate sales representatives since adoption of the Rate Order. (Fifteen cents is, in fact, a typical marginal per channel benchmark. *See* Disney Petition at 14.)

7 Third Notice at ¶ 143.

8 Disney agrees with the Commission that the first and second approaches described in the Third Notice are inconsistent with the logic of the benchmark system. In these Comments, as in our Petition, The Disney Channel does not comment on the benchmark system itself or the underlying rationale, factors, methodology or survey data used to create it. Many parties have filed extensive comments on this subject, and the Commission may well decide in its *Second Reconsideration* that changes to the benchmark system are warranted. *See* Third Notice at n. 245. Obviously, we do not know what changes the Commission might make in the benchmark system, or how far-reaching these changes may be. Accordingly, we cannot assess now whether any such changes would affect our support of the (Footnote 8 Continued)

of ensuring that cable operators retain the incentive to add program services while protecting consumers from unreasonably high fees. The way to achieve these dual objectives is to permit cable operators to recoup their costs and earn a reasonable profit.

Third, the third approach has the advantage of being easy to implement because the calculation does not require ongoing historical data; only the current permitted per channel rate (Line 600 of Form 393) and the average per channel program cost are needed.[9] The administration and verification of costs and rates, both of which are goals of the Act and the Commission,[10] will thus be easier under the third approach.

For these reasons, Disney believes the third approach -- with the small, but important, modifications discussed below -- should foster Congress' and the Commission's goals.

(Footnote 8 Continued)
third approach. Nevertheless, absent drastic and fundamental changes in the benchmark system, we anticipate that the third approach methodology should still work.

9 It is to retain ease of implementation of the methodology that we do not believe that the Commission should require advertising revenues to be deducted from program costs (*see* Third Notice at n. 244). There is no question that doing so would benefit The Disney Channel by eliminating the incentive cable operators otherwise have to favor advertiser-supported services in deciding which program services to add. (Cable operators on average earn $1.50 per month per cable home from local advertising revenues. The Kagan Media Index, July 26, 1993, at 8. Cable operators earn additional revenues from home shopping channel commissions.) But there is also no question that such a procedure would complicate the methodology of the third approach immensely; indeed, the process could become more like a cost-of-service proceeding. To retain the benefit of ease of administration and verification, the Commission should not require program costs to be offset by advertising revenues or home shopping commissions.

10 *See* Third Notice at n. 243.

A. Cable Operators Should Be Permitted Not Only To Recoup Their Programming Costs But Also To Earn A Reasonable Return On Investment

The Commission has asked for factual information with respect to cable operators' decisions to add program services. The factual information that we offer the Commission is based on our first-hand experience in our marketing of The Disney Channel to cable systems.

The facts are unequivocal. *Since the Commission issued its Rate Order, not a single cable system has added The Disney Channel to a regulated tier. By contrast, in the 12 months preceding the Rate Order, an average of 19 cable systems per month added The Disney Channel to a program tier.*[11] Clearly, the momentum was building for adding The Disney Channel to a program service tier prior to adoption of the Rate Order. That momentum ran into a brick wall in April, 1993.

The most common reason cable operators have offered us for their decisions since the Rate Order not to add The Disney Channel to a program tier is that they cannot, under the benchmark system, recoup their cost and make a reasonable return on investment. While the Commission's third approach appropriately permits cable operators to recoup their programming costs, it does not currently provide for a return on investment based on actual programming costs.[12] The Commission seeks comment on this position and requests certain specific information concerning profit margin.[13]

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11 From April 1992 to March 1993, a total of 224 cable systems (an average of approximately 19 per month) added The Disney Channel to a programming tier after previously offering it on an a la carte basis.

12 Third Notice at ¶ 143. The formula established by the Commission does not include a profit factor.

13 *Id.* at n. 244.

We note, first and foremost, that the cable operator's ability to earn a reasonable profit is mandated by and is consistent with the Act.[14] Indeed, as the Commission acknowledges, Congress singled out programming in suggesting a pass-through and very clearly stated that it had "no desire to regulate programming."[15] In order to ensure that it does not unwittingly regulate cable operators' programming decisions, the Commission should ensure that cable operators are able not only to recoup costs, but also to earn a reasonable return on newly added program services. By so doing, the Commission will be fulfilling the Act's mandate.

Programming decisions must include the ability to decide *how* a service is offered -- *i.e.,* on a program tier or a la carte. Because a la carte offerings are unregulated, there is no regulatory limit to the profit that the cable operator can charge. Thus, a cable operator will never agree to move an a la carte service to a program tier unless it can continue to recoup its costs and earn *some* profit.[16] Although the Act encourages a la carte offerings, the fact is that until systems are fully addressable, offering services on an a la carte basis can make them more expensive to the consumer.[17] It is also a fact that today, when most systems are not

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14 47 U.S.C.A. § 543(b)(2)(e)(vii) (West Supp. 1993).

15 Rate Regulation Report and Order, MM Docket No. 92-266, Report No. 93-177 (released May 3, 1993) at ¶ 8.

16 In our view, the more expensive (and the more popular) a programming service, the stronger the bias against moving a service to a regulated tier. The third approach will not eliminate this bias but at least, with a profit factor, will permit the cable operator to consider moving such a service if it determines that there are reasons for doing so *(e.g.,* consumer preference).

17 Disney Petition at 11. As we explained in our Petition, our research demonstrated that when The Disney Channel was purchased on a per channel basis, subscribers' total cable bills averaged $29 per month. In contrast, when The Disney Channel was purchased as part of a tier, subscribers' total cable bills averaged $19.50 per month, a savings of almost $10 per month. *Id.* at 5.

fully addressable, cable programming services are sold on tiers. For Disney to function effectively in this environment, it too must have the tiering option available.[18]

For these reasons, a profit factor based on actual programming costs is necessary to preserve a cable operator's incentive to add programming services such as The Disney Channel to regulated tiers, thereby making the service available to more viewers at a substantially lower cost. The Commission has already stated that it will establish a reasonable amount for a return on investment in the cost-of-service proceeding.[19] This amount, once determined, should also apply to increased programming costs under the third approach. However, given the need to resolve the programming cost issue as soon as possible in order to establish the incentive for cable operators to invest in programming, we encourage the Commission to adopt an interim reasonable profit factor, pending completion of the cost-of-service proceeding.

B. Cable Operators Should Be Permitted To Adjust Their Rates Under This Methodology When Their Program Lineups Change, Even If Channels Are Not Added To Or Deleted From Regulated Tiers

The third approach should be modified to permit upward adjustments (and require downward adjustments) when programming costs change as a result of program lineup changes, not just when channels are added or deleted.

Many cable operators may not have the technical capability to add channels. Nevertheless, these cable operators may want to change their program lineups and could incur

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18 *Id.* at 5.

19 Third Notice at n. 244.

changes in programming costs as a result.[20] After all, it is in the best interest of consumers to have cable operators continually examine their programming choices to ensure that what they offer is what their customers want. Thus, just as the Commission properly concludes that the third approach should apply when a program service is added by simply activating unused channel capacity (as distinguished from adding new channel capacity), so too should the third approach apply when a new program service is added by replacing another service.[21] Both situations result in a change in programming costs resulting from changes in program lineups. If the operator cannot recoup its costs plus earn a profit in such a case, the incentive to add new services -- which the Commission properly seeks to preserve -- will be eliminated.[22] This incentive for the cable operator should not depend on whether a new service is being added to an empty channel or replacing an existing service.

To achieve the stated goals and objectives of Congress and the Commission, therefore, the third approach should permit a recalculation of rates whenever a system's program lineup changes, regardless of whether a channel is added or deleted.

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20 For example, if a cable operator takes a program service off the regulated tier and replaces it with The Disney Channel, because Disney has a higher than average license fee, the average per channel program cost will most likely increase, even though the number of regulated and satellite channels remains the same.

21 Third Notice at n. 248.

22 In the event that a new, more expensive service replaces another service, the operator will only be allowed to recoup the net change in programming costs. For example, if the cable system's programming costs for regulated channels is $3.00, and due to the lineup change this amount increases to $3.25, even if the cost of the new program service is $0.50, only the $0.25 (to the extent it exceeds inflation) would be the adjustment amount.

CONCLUSION

Since the Rate Order was adopted, not a single cable system has added The Disney Channel to a regulated tier despite the expressed interest in doing so on the part of many cable operators and the attendant benefit to consumers. This has occurred because the regulatory scheme impedes a system's ability to recoup costs and earn a reasonable return on investment. The Commission has appropriately recognized that this result hurts consumers and is inconsistent with Congress' goal of preserving cable operators' incentive to add new program services.

The Commission's proposed third approach to correcting this problem is the best of the proposals, but should be modified slightly (1) to include a factor for cable operators to earn a reasonable profit based on actual programming costs and (2) to apply whenever a cable system's program lineup changes, regardless of whether new channels are added. In order to establish the incentive for cable operators to invest in programming and thereby benefit consumers, the Commission should act immediately.

Respectfully submitted,

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